

Private foundations; taxable expenditures. A private foundation that made grants to individuals after 45 days from the date it submitted an exemption application in accordance with procedures fully disclosed in its application did not make taxable expenditures under section 4945 of the Code, even though the foundation did not specifically request advance approval of its procedures.

ISSUE

Did a private foundation make taxable expenditures within the meaning of section 4945(d)(3) of the Internal Revenue Code when it made grants to individuals under the circumstances described below?

FACTS

A newly created nonprofit organization applied for exemption from federal income tax in 1980 as a private foundation under section 501(c)(3) of the Code. The application disclosed its intent to provide scholarship grants to individuals for study at educational institutions under procedures that were fully described in materials submitted as part of the application. The description of the procedures included a detailed statement describing the selection process, a description of the terms and conditions under which the organization ordinarily makes grants, a detailed description of its procedures to supervise grants, and a description of procedures to review grantee reports, investigate possible diversion of grant funds and recover diverted grant funds. While the scholarship program meets the requirements required for the approval of such grants, the application made no specific request for approval of its procedures.

In 1980, the Internal Revenue Service recognized the organization as a private foundation exempt from federal income tax under section 501(c)(3) of the Code. The exemption letter neither expressly approved nor disapproved the organization's procedures for providing grants to individuals. Upon receipt of this letter, the organization began to make grants to individuals in accordance with the procedures described in its application.

LAW AND ANALYSIS

Section 4945 of the Code imposes a tax on each taxable expenditure made by a private foundation.

Section 4945(d)(3) of the Code provides that the term 'taxable expenditures' includes any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes except as provided in section 4945(g).

Section 4945(g) of the Code provides that a grant to an individual for study that is made on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary is not a taxable expenditure under section 4945(d)(3) if it is demonstrated to the satisfaction of the Secretary that (1) the grant constitutes a scholarship or fellowship grant which is subject to the provisions of section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii); (2) the grant constitutes a prize or award that is subject to the provisions of section 74(b), if the recipient of such prize or award is selected from the general public; or (3) the purpose of the grant is to achieve a specific, objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee.

Section 53.4945-4(a)(3)(ii) of the Foundation Excise Tax Regulations provides the general rule that grants to individuals for travel, study or similar purposes will be taxable expenditures under section 4945(d)(3) of the Code, unless, among other requirements, the grants are made pursuant to procedures approved in advance by the Commissioner.

Section 53.4945-4(d)(1) of the regulations provides that a request for advance approval of a foundation's grant procedures must fully describe the foundation's procedures for awarding grants and for ascertaining that such grants are used for the proper purposes. The request must contain: (1) a detailed statement describing the selection process; (2) a description of the terms and conditions under which the foundation ordinarily makes grants; (3) a detailed description of the foundation's procedure for exercising supervision over grants; and (4) a description of the foundation's procedures for review of grantee reports, for investigation where diversion of grant funds from their proper purposes is indicated, and for recovery of diverted grant funds.

Section 53.4945-4(d)(3) of the regulations provides that if, by the 45th day after a request for approval of grant procedures has been properly submitted to the Service, the organization has not been notified that such procedures are not acceptable, such procedures shall be considered as approved from the date of submission until receipt of actual notice from the Service that such procedures do not meet the requirements of section 4945(g) of the Code. If a grant to an individual for a purpose described in section 4945(d)(3) is made after notification to the organization by the Service that the procedures under which the grant is made are not acceptable, such grant is a taxable expenditure.

Organizations applying for tax exemption and seeking advance approval of their procedures for grants to individuals may request such approval with their submission of Form 1023,

Application for Recognition of Exemption under Section 501(c)(3) of the Code. A full and complete disclosure of an organization's grant-making procedures that includes the information required by section 53.4945-4(d)(1) is considered equivalent to a request for advance approval when submitted in conjunction with an exemption application. However, approval of an organization's exemption application does not in itself constitute approval of the organization's grant procedures unless the exemption letter so provides.

The organization's full disclosure of its grant-making procedures in its exemption application constituted a properly submitted request for approval of grant procedures within the meaning of section 53.4945-4(d) of the regulations. The 1980 approval of its exempt status, however, did not itself constitute an approval of its grant procedures. Nevertheless, because it did not receive, by the 45th day after submission of its application notification that its procedures were not approved, the organization's procedures are considered to have been approved from the date of its application under the provisions of section 53.4945-4(d)(3) of the regulations. Consequently, the organization's grants to individuals were not taxable expenditures under section 4945(d)(3) of the Code.

HOLDING

Under the circumstances described above, the private foundation did not make taxable expenditures within the meaning of section 4945(d)(3) of the Internal Revenue Code when it made grants to individuals.